

September 1, 2000

by Hand

Mary L. Cottrell, Secretary

Department of Telecommunications and Energy

One South Station, 2nd Floor

Boston, MA 02110

Re: Massachusetts Electric Company: Proposed Increase in Standard Offer Service Rate

Enclosed on behalf of Massachusetts Electric and Nantucket Electric Company (together "Mass. Electric" or "Company") are testimony and exhibits supporting a proposed increase in the Company's Standard Offer Service rate which is proposed to be effective for usage on and after October 1, 2000.

Background

As described in the testimony, oil and gas prices are at historically high levels. This extraordinary inflation in fuel costs has had a substantial and significant impact on Mass. Electric's power supply costs. Specifically, provisions of the Company's Standard Offer Service supply contracts that are designed to compensate its suppliers for extraordinary increases in their fuel costs have been triggered in 2000. While Mass. Electric's cost of power supply has escalated dramatically, the rate for the service has remained unchanged at 3.8¢ per kWh. As a result, the Company is beginning to build up substantial cost deferrals that will have to be collected from customers at a later date. As such, Mass. Electric is proposing to increase its Standard Offer Service rate to match its current costs to the rate charged to customers for the fourth quarter of 2000. Accordingly, the Company is proposing to increase the Standard Offer Service rate from the current 3.8¢ per kWh to 4.994¢ per kWh.

Consistency with Settlement and Restructuring Act

The Company's proposed increase is expressly permitted by the terms of the Company's Restructuring Settlement from D.T.E./D.P.U. Docket 96-25. In addition, it is consistent with the provisions of the Electric Utility Restructuring Act of 1997 (the "Act"). As described in testimony included in the filing, both the Company's Restructuring Settlement and the Act require the Company's rates to be capped through an inflation factor, benchmarked to rates from prior to restructuring. Specifically, Section I.B.(9) of the Company's Restructuring Settlement uses the Consumer Price Index ("CPI") as the measure of inflation, but specifically permits the effects of extraordinary inflation in fuel costs in determining whether the inflation-based rate cap has been exceeded by excluding the fuel index payments from the calculation. The Department approved the Company's Restructuring Settlement and found that it substantially complied with and was consistent with the Act in Docket 96-25-B.

The Restructuring Settlement and the terms of the Act are substantially the same in how the inflation cap should be calculated. Although the Act does not specify the methodology to be used to determine the inflation cap, it gives the Department wide discretion to determine and adjust the measure of inflation to maintain the economic value of the initial rate reduction. Specifically, Section 1B(e) of the Act expressly states:

"The calculation and implementation of the rate reduction and the inflation cap shall be subject to adjustment, review, and approval in accordance with procedures in the rules and regulations promulgated by the department, which shall require that, the economic value of the rate reduction required under this section, be maintained during the standard service transition period."

Consistent with the Restructuring Settlement, the Department initially approved the CPI as a measure of inflation for purposes of implementing the inflation cap. In fact, this index is a reasonable measure of inflation in terms of electricity costs when there is no extraordinary inflation in fuel costs that affect energy prices. However, when there is an extraordinary increase in the cost of fuel that is beyond the control of the Company, it is reasonable and appropriate for the Department to take such events into account when applying the inflation cap under the Act. Of course, when fuel costs later moderate, it would then be appropriate to return to using the CPI, standing alone, to measure inflation. That is precisely how the mechanics of the Company's Restructuring Settlement operate.

In order to appropriately reflect this extraordinary inflation, the Company proposes to reflect the increases from the fuel index in the calculation, as was contemplated in the Company's Restructuring Settlement. Once the rolling average of fuel prices falls below the fuel index trigger value, the effect of the prior fuel index calculations of the inflation factors would be removed.

Importance of Approving Proposal

Mass. Electric believes it is extremely important for the Department to approve the Company's request. Although the increase will have a significant impact on customer electric bills today, the situation could be much worse at a later date if the Department does not take action now. Specifically, the amount deferred to date is approximately \$50 million. The Company is not asking at this time to collect this deferred amount. Rather, the Company is simply asking the Department to halt the escalation in deferred costs. If action is not taken, the deferral could build to almost \$400 million by the end of 2001, leaving a staggering rate recovery problem for future generations of Mass. Electric customers. If, however, the Company's proposal is approved, the Company will be able to

remain current with its expenses and revenues and deal with a more manageable deferral at a later date.

For all of these reasons, the Company respectfully requests the Department approve the Company's request.

Sincerely,

Ronald T. Gerwatowski

General Counsel

cc: Ronald F. LeComte, Director of the Electric Power Division, Dept. of
Telecommunications and Energy

George B. Dean, Esq., Office of the Attorney General

David L. O'Connor, Commissioner, Department of Energy Resources

Judith A. Silvia, Esq., Associated Industries of Massachusetts

Service List, D.T.E./D.P.U. 96-25